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# Corn: record crops, but inventories will shrink

Corn prices continue to languish aimlessly. Where to from here?

As of the most recent planting progress report, 84% of the 2017-18 US crop to be harvested this coming fall has been planted, compared with 84% last year at this time and the five-year average of 85%.

For a while, there was concern that despite the normal planting pace, there would be problems with the crop because emergence was very slow on account of wet weather and unseasonably cold temperatures. Replanting – a risky strategy – was being seriously considered in some regions. However, as of the most recent crop progress report, emergence has snapped back. At 54%, it is still behind last year at this time when 58% of the crop had emerged, but only a tad below the five-year average of 55%.

We must bear in mind that this season has a particular vulnerability in that US farmers have reduced planted area rather dramatically in favor of soybeans (see *Focus on Futures*, April 21).

The May USDA crop report incorporated the March 31 planting-intentions estimate into its first comprehensive look at the 2017-18 crop year. As is traditional, the initial yield estimate was conservative at 170.7 bushels per acre (bpa), down from the record yield set in 2016-17 of 174.6 bpa. Perhaps the USDA was merely discounting the late emergence, and we can expect the June crop report to up the yield estimate. The current forecast puts the crop at 14.065 billion bushels (357.27 million tonnes), compared with 15.148 billion bushels (384.78 million tonnes) for 2016-17.

The forecast for the other two major producing/exporting nations – Brazil and Argentina – are 96 million tonnes and 40 million tonnes, respectively, about the same as for 2016-17. South American estimates are meaningless at this time of year because the current harvests are just wrapping up.

The drop in US output – with support from the forecast for record global demand – will result in the first global production/consumption deficit since 2010-11. The extraordinary crops grown by US, Brazilian, and Argentinean farmers in 2016-17 will still leave global inventories vulnerable to a crop accident. With the USDA's May estimates, global ending stocks as a percentage of consumption will fall to 18.4%, the lowest level since 2013-14 and well below the three-year average of 21.6%.

Even if we pencil in US yields at 2016-17 levels, ending-stocks would rise to just 18.9% of usage. This is not the scenario envisioned by anyone just a few months ago.

Demand remains strong. Weekly US export sales remain steady. Commitments stand at 52.8 million tonnes. The USDA target is 56.52 million tonnes. Expect the new-sales pace to slow as South American supplies become available, but the marketing year extends to August 31, so we're well positioned to meet the target.

One final note: The growth rate of corn-based ethanol production has certainly slowed, but the USDA estimate for the new marketing year calls for record output of the corn equivalent of 5.5 billion bushels, 100 million bushels higher than in 2016-17.

Now that most of the crop is in the ground, were prices to trade back down to the low end of the range, it should mean that fears of a crop failure were unfounded. Remain long July corn, but raise stop losses suggested on April 2 from $3.40 per bushel, to $3.60, close only.

*[Sholom Sanik, May 23, 2017]*

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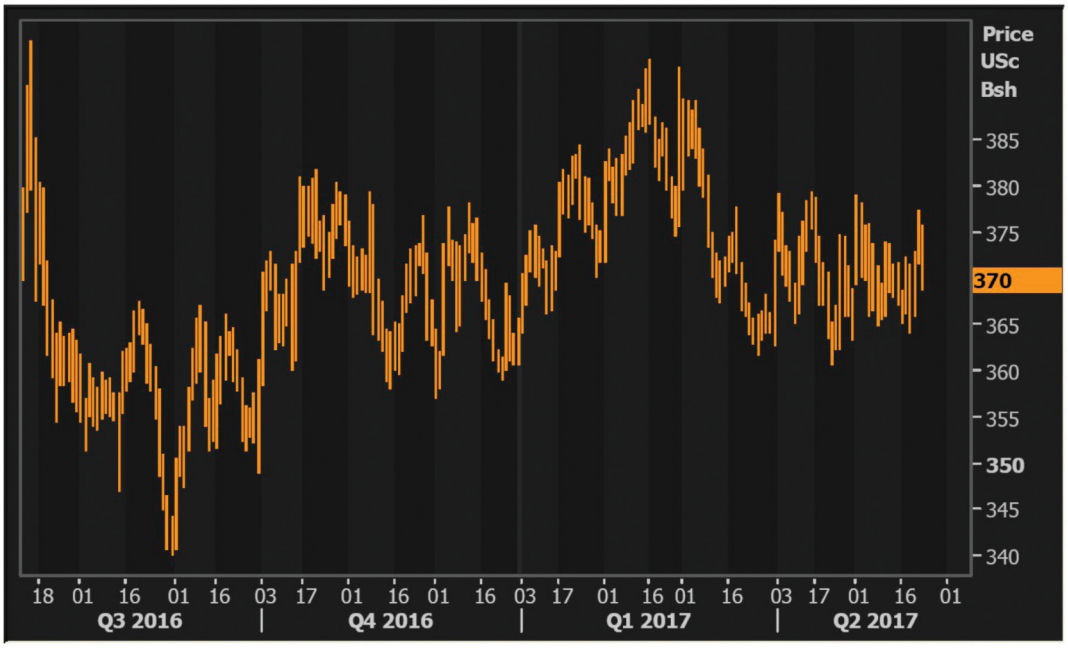
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**Chart 1 – July corn**




*Courtesy Reuters*

## COPPER

# Supply down, but so is demand

Chilean copper production for the first four months of the year has plunged, primarily on account of the strike at the huge Escondida mine. The strike ended in late March, but not before an extraordinary amount of production vanished, with year-over-year losses in February and March of 16.7% and 23%, respectively. There were other contributing factors, such as shutdowns at other mines due to maintenance and water problems.

Chilean output was expected to climb by 4.3% this year, to 5.79 million tonnes, but that forecast has been slashed to a gain of only 2%. This revised forecast could be optimistic, as it represents precisely the amount of output that was lost during the strike, which would mean that mining efficiency would have to be near perfect for the balance of the year. With April output down 1.8%, the post-strike period has not yet shown any signs of recovery.

The strike was far reaching for Chile because traditionally more than half of Chilean export revenue is attributed to foreign copper sales.

Copper prices rose to $2.70 per pound from $2 per pound in the months before the Chilean labor strife came to a head (Chart 2). With the exception of nickel, which suffers from a chronic supply overhang, prices of the other principal base metals – aluminum, zinc, lead, and tin – have been rising this year, all trading at or near multi-year highs. This would seem to underscore ideas that the underlying supply/demand fundamentals for internationally-traded, industrial materials are quite strong.

However, the market spiked to two-year highs just when the strike began in early February and has been grinding downwards since. It would be difficult not to invoke the buy-the-rumor-sell-the-news principle.

Why would the market not have built on the rally with the support of a material drop in supply from the world's largest copper mining nation?

The answer could lie on the demand side of the balance sheet. While Chilean output is the single largest supply-side variable, Chinese imports are the swing factor on the consumption side. And they have mellowed.

Average monthly net refined copper imports over the past 12 months have declined by 28% compared with a year earlier (Chart 3). For whatever the reason, Chinese importers were buying copper. Whether it was for *bona fide* industrial usage or to be used as collateral for loans, the copper purchased abroad was coming off the market. It was a bullish constant for several years, but has now mitigated the impact of dwindling Chilean supplies.

Chart 4 shows that international warehouse stocks – LME, Shanghai, and Comex – have drooped recently, but overall have been building since 2015.


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Our bullishness in the past has been based on the combined effect of lackluster growth in mining output pitted against a seemingly insatiable Chinese appetite for copper. The former remains in full gear. If there is no improvement in Chinese buying, however, the bullish case is weakened.

Owing to the unusual drop in Chilean output, we would give our long position the benefit of the doubt, weak Chinese imports notwithstanding. Raise stops to $2.50 per pound, basis the nearest contract, close only.

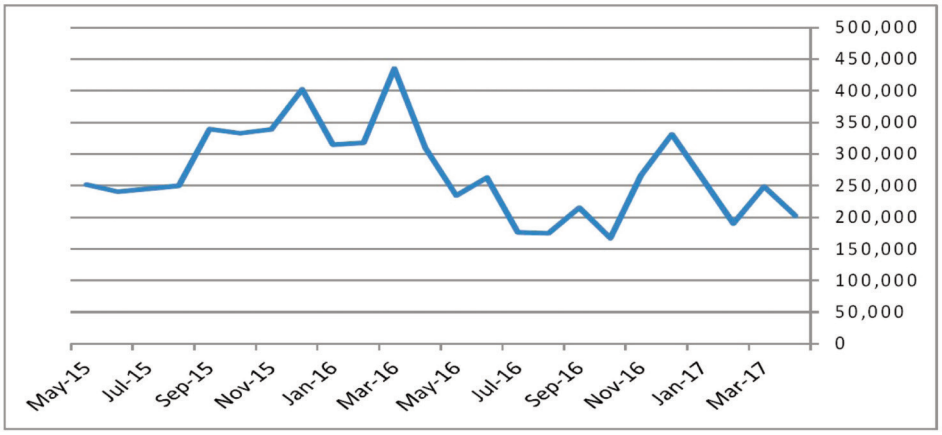
*[By Sholom Sanik, June 9, 2017]*

**Chart 2 – September copper**



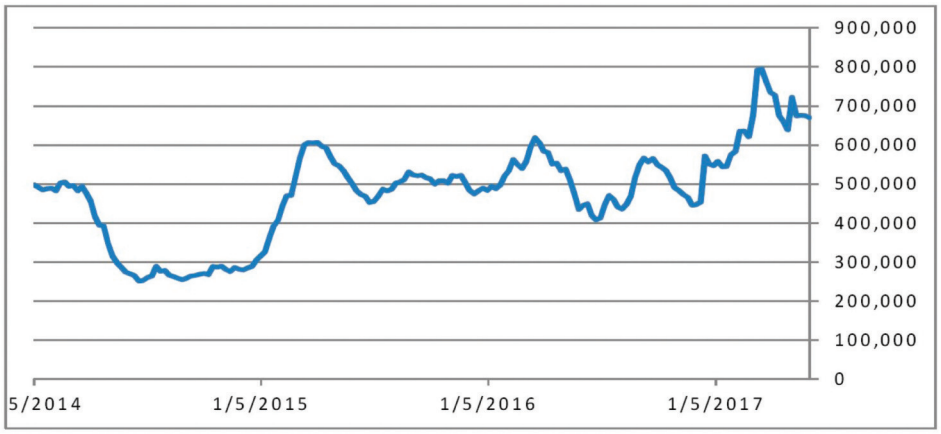

*Courtesy Reuters*

**Chart 3 – Chinese monthly net imports (tonnes)**




*Source: Reuters*

**Chart 4 – Combined warehouse stocks (LME, Shanghai, and Comex)**




*Source: Reuters*


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## COTTON

# Larger crop puts the bull on hold

Back in mid-May, in the space of just three trading sessions, old-crop cotton prices took a wild ride, rallying 10¢ per pound, or about 13% (Chart 5). The short-term squeeze was triggered by falling domestic stocks.

US ending stocks for the 2016-17 marketing year, which ends on July 31, are estimated to fall to 3.2 million bales, or 18% of consumption. That compares with 24.6% and 30%, in 2014-15 and 2015-16, respectively. While the crop harvested last fall was the largest since 2012-13, the market was still feeling the effects of the previous season's anemic output. But exports surprised to the upside all season long, depleting already vulnerable inventory levels.

To illustrate, consider that at harvest time for the 2016-17 crop last fall, the estimate for US exports was 12 million bales, but has now climbed to 14.7 million bales. With seven weeks left to the marketing year, export commitments stand at 13.8 million bales. Given the pace of shipments over the past four weeks, final sales may come in a bit short of the target, but all told, foreign demand has been far higher than any analyst expected just a couple of months ago. Hence, the squeeze should not have come as much of a shock.

Looking forward, farmers in all of the major producing countries will be growing larger crops this year. That includes India, China, and the US, in addition to gains in smaller producers. Consumption continues to grow, however, so we will nevertheless see a second consecutive year of consumption/production deficits.

The bear market that drove prices down to 57¢ per pound in early 2016 was the direct result of burdensome Chinese stocks. The decision by the government to disincentivize imports by selling off cotton from inventory reduced Chinese imports from a peak of 24 million bales in 2011-12 to the forecast for a scant 5 million bales in 2017-18.

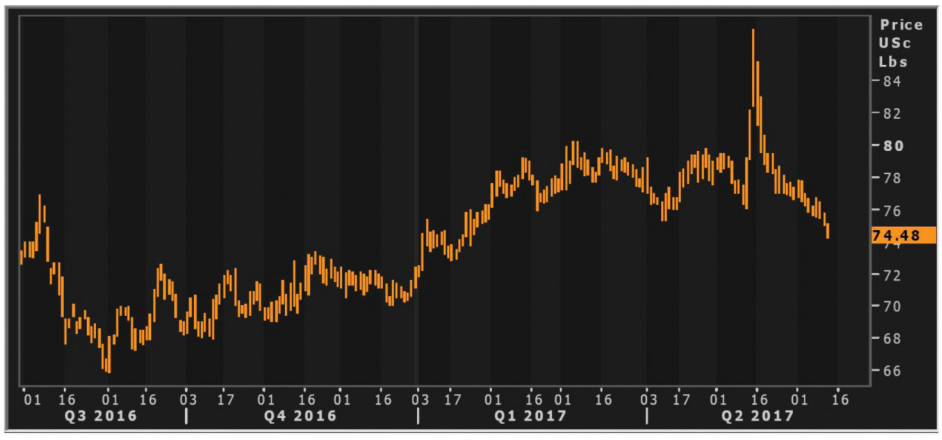
At this point the Chinese have liquidated a significant portion of those inventories. Of particular significance – although it's impossible to know the exact ratio – there is probably little left in the way of high-quality cotton that would meet the standards required for export to the US and Europe. According to the USDA, Chinese ending stocks have fallen from a high of 67 million bales in 2014-15 to the current level of 39 million bales.

In 2014-15 global ending stocks stood at 111 million bales, or 100% of usage. And the situation still looks a bit scary – at least when compared with inventory levels of other commodities. The June USDA crop report put ending stocks at 88 million tonnes, or 75% consumption. We maintain that, as mentioned above, much of that stockpile is dormant because it cannot be used in mills that are manufacturing fibre for export to Western countries anyway.

The market is focusing on the new crops in the US and Asia, as evidenced by the fact that the new-crop December contract did not participate in the squeeze that we saw for the old-crop contract months. December had something of a "sympathy" rally, but prices remained confined inside a five-month trading range (Chart 6). US farmers have planted 92% of the crop, and the good-to-excellent portion of the crop is 66%, the highest rating for this time of year since 1994. That will cause pressure on prices.

We therefore suggest liquidating long positions in July cotton, established on February 8. Down the road, we would look for upward revisions to Chinese imports. Were the Chinese to resume regular imports, the market should move back up into its long-standing trading range, and we would consider re-entering the long side. For now though, we will abide by the clear-to-see breakdown in December cotton. Stay tuned. *[By Sholom Sanik, May 4, 2017]*

**Chart 5 – July cotton**




*Courtesy Reuters*


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**Chart 6 – December cotton**




*Courtesy Reuters*

## SUGAR

# A warranted collapse?

Sugar prices have plummeted by 40% from their peak in early February. After two consecutive seasons of global production/consumption deficits, traders are reacting to forecasts that the 2017-18 balance sheet will move back into surplus. The anticipated shift is the result of increased production in India and the perception of more supply from the EU, as well as stagnant consumption.

**India**

The monsoon between June and September is crucial for Indian crops. The current 2016-17 season was a disaster on account of the lingering effects of a weak monsoon in calendar year 2015, particularly for Maharashtra – normally the largest-producing state. Indian output sank to below 21 million tonnes, down from 25 million tonnes in 2015-16. Inventories were down to near-record lows.

Precipitation for this year's monsoon has returned to normal levels, but it is early to say that the parched areas are completely out of the woods. Sugar output in Maharashtra is estimated to bounce to 6.8 million tonnes in 2017-18, about 60% higher than in the previous drought-ravaged season. The recovery in Maharashtra alone is expected to account for about half of the Indian comeback.

Changes in currency denominations – the discontinuation of 500 and 1,000 rupee notes – allegedly put a damper on domestic sugar consumption – at least that is the story that was circulating. Still, at the very least, domestic consumption in India is roughly 25 million tonnes, the same amount as will be produced in the new marketing year. The larger crop and improved yields will therefore do nothing in terms of padding ending stocks.

Not only will India cease being an exporter for the second consecutive season, we're guessing that the government will maintain the relaxed import regime, should imports be needed.

**EU**

A good deal of price weakness we've seen over the past several months was inspired by the elimination of the EU export quota system. It was assumed that about 3 million tonnes of sugar will become available for export as farmers were motivated by both the government's move and higher prices.

The problem, however, is that it has been a dry spring and early summer in some key beet-growing regions. Early forecasts for a jump in 2017-18 sugar production to 18.3 million tonnes, up from 16.5 million tonnes in 2016-17, are in jeopardy.

**Thailand and Australia**

Thai output for 2017-18 is expected to increase by about 1 million tonnes, but will be partially offset by a 300,000-tonne drop in Australian production, the result of crop losses caused by a cyclone.

**China**

The Chinese government has been threatening to impose import duties. Imports are cheaper than controlled domestic prices and have been flooding the Chinese market. According to official statistics, the Chinese have


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enough inventory to sell sugar to the domestic market. However, they also continue to run an annual production/consumption deficit of over 5 million tonnes. Sooner or later they will have to accommodate imports, if not in 2017-18, then in 2018-19. In any case, the government's own estimate puts 2017-18 imports at 3.2 million tonnes, down just slightly from 3.5 million tonnes in 2016-17.

**Brazil**

Analysts are forecasting Brazilian Center South output for 2017-18 at about 35.5 million tonnes, slightly below last year. Thus far, there has not been any noticeable shift in the ethanol/sugar output ratio. We believe that with sugar prices below 13¢ per pound, it is only a matter of time before the incentive to increase ethanol output appears.

In early 2016, when sugar was trading at about current levels, we argued that mills – particularly in Brazil – were losing money. Production fell, and we saw global deficits. True, dry weather in Asia was the primary spark that saw the market rally to as high as 24¢ per pound. But we're back to square one in terms of the industry's ability to continue to crush cane in an environment of financial hardship.

In conclusion, analysts are forecasting a global production/consumption surplus of about 3.5 million tonnes for 2017-18. This compares with a deficit of roughly 5 million tonnes for 2016-17. These estimates do not include the revised output estimates for the EU that we anticipate, nor do they account for higher ethanol production for the balance of the Brazilian crushing season – something we believe is inevitable.

Commodity funds have switched from a massive net-long position of 160,000 contracts earlier this year to a net-short position of 86,000 contracts. A private weekly survey of analysts that we monitor shows 55% of respondents are bearish, 33% neutral, and a mere 11% bullish. With such negative sentiment appearing after the market has fallen so dramatically and our belief that the estimate for the size of the surplus for the new marketing year is overstated, we are confident that there is a short-covering rally just around the corner.

There is precious little value, if any, remaining in the October call options we've advised purchasing. We recommend accumulating March 2018 16¢ calls, currently trading at about 60 ticks.

*[By Sholom Sanik, June 30, 2017]*

**Chart 7 – October sugar**




*Courtesy Reuters*

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